

2011 Legislative Proposals
BOARD Meeting December 2, 2010

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| A | Clean Up the Franchise Tax Board Mandate to Suspend Practitioners Based on the Federal Suspension or Disbarment |
| B | Exempt Organizations/Filing Fees |
| C | Transfer the Collection of Department of Industrial Relations Debts from the Franchise Tax Board to the Employment Development Department |
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LEGISLATIVE PROPOSAL A

EXECUTIVE SUMMARY

- **Title:** Clean Up Franchise Tax Board (FTB) Mandate to Suspend Practitioner Based on Federal Suspension or Disbarment
- **Problem:** This legislative proposal would resolve the following three problems:
 1. Current law requires that the FTB provide tax practitioners suspended or disbarred from practicing before the IRS, after the federal government has provided the right to a full evidentiary hearing, an administrative proceeding, subject to all the rules and protections of the California APA, on whether the federal determination was clearly erroneous, which is an overly rigorous proceeding for a hearing of such narrow scope.
 2. Current law fails to specify the date that interest begins to accrue on the penalty for failure to notify the FTB timely of a federal suspension or disbarment.
 3. Current law fails to provide the FTB express authority to publish the names of suspended or disbarred practitioners, which could lead to the allegation that publication is a disclosure violation under R&TC section 19542.
- **Proposed Solution/Justification:** Amend R&TC section 19523.5 to do each of the following:
 1. Recast the proceeding to determine whether the federal determination was clearly erroneous as a hearing before FTB staff that is excluded from the APA requirements, including the requirements that an ALJ preside over the hearing and that the rules of evidence apply.
 2. Explicitly state the date that interest begins to accrue on the penalty by specifying that the penalty becomes due and payable upon notice and demand by the FTB.
 3. Provide express authority for the FTB to publish and maintain a list of practitioners who are currently suspended or disbarred from practice before the FTB, including the suspension period, as a result of an existing federal suspension or disbarment. Practitioners who have been reinstated to practice before the IRS would have their names removed by FTB from the published list by providing a copy of the federal reinstatement notice to the FTB.
- **Costs:** Excluding the required proceeding from the APA requirements so that the hearing would be conducted by department staff rather than an ALJ would reduce departmental costs by an estimated \$140,000 in year one and \$40,000, thereafter. The cost to create the internal processes to implement this proposal would not significantly affect the department's costs.
- **Revenue:** This proposal would not directly impact the state's income tax revenue.

Title

Clean Up Franchise Tax Board (FTB) Mandate to Suspend Practitioner Based on the Federal Suspension or Disbarment

Introduction

This proposal would make several changes to California law requiring that federally suspended or disbarred tax practitioners would also be prohibited from representing taxpayers before the FTB during the period of the federal suspension.

Current Federal Law

Rules governing the regulation of attorneys, certified public accountants (CPAs), enrolled agents (EAs), enrolled actuaries, and other persons representing clients before the IRS are spelled out in Treasury Department regulations popularly known as Circular No. 230 (Circular 230).¹ Circular 230 specifies the requirements practitioners must meet, their duties, and provides sanctions for practitioners who fail to comply.

Practice before the IRS contemplates all matters connected with a presentation to the IRS relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS. These presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the IRS, and representing a client at conferences, hearings, and meetings.

Simply preparing a tax return, furnishing information at the request of the IRS, or appearing as a witness for the taxpayer is not considered practicing before the IRS under Circular 230. However, only a properly authorized and qualified individual will be allowed to advocate for a taxpayer, as a representative, on any issues raised.

After due notice to the practitioner and an opportunity for a proceeding before an Administrative Law Judge, the IRS may censure (publicly reprimand), suspend, or disbar any practitioner from practice before the IRS if the practitioner:

- Is shown to be incompetent or disreputable,
- Refuses to comply with any of the Circular 230 requirements, or
- With intent to defraud, willfully and knowingly misleads or threatens a client or prospective client.

A disciplinary proceeding is initiated when the Director of the Office of Professional Responsibility (Director) files a complaint with an Administrative Law Judge (ALJ) containing the charges, specification of the sanction sought, and a demand for answer. A practitioner's failure, after having been served a copy of the complaint, to answer the complaint by the deadline constitutes an admission of the allegations and a waiver of the hearing that allows the ALJ assigned to the complaint to make a decision by default.

¹ http://www.irs.gov/pub/irs-utl/circular_230.pdf

An evidentiary hearing must be held for a disciplinary proceeding prior to the ALJ rendering a decision, with the following exceptions:

- the Director withdraws the complaint,
- the practitioner fails to file an answer by the deadline,
- the proceeding is an expedited suspension, or
- the practitioner requests a decision without a hearing.

The expedited suspension process applies to practitioners who, within five years of the date that a complaint is filed, have had their state license to practice law or accounting or to practice as an actuary suspended or revoked for cause or have been convicted of specified crimes, or have violated conditions imposed by the Director.

In lieu of a proceeding being instituted or continued, a practitioner may, subject to the Director's acceptance, request a voluntary sanction.

The ALJ's decision may be appealed by either party to the Secretary of the Treasury (Secretary). Absent an appeal, the ALJ's decision becomes the Secretary's decision.

A decision on suspension or disbarment becomes final when either:

1. 30 days have passed since the ALJ decision was made and neither party has appealed the decision to the Secretary or the designee; or
2. The Secretary or designee has issued his or her decision.

Although a practitioner may appeal the Secretary's decision to the Federal District Court, the Secretary's decision may be made public and the term of any suspension or disbarment will begin.

Circular 230 prohibits tax practitioners from accepting assistance from, or assisting, any person who is disbarred or suspended. To enable attorneys, CPAs, EAs, and enrolled actuaries to identify restricted persons, the IRS announces the name, city and state, professional designation, effective date of disciplinary action, and period of suspension of each restricted person.

Current State Law

R&TC section 19523.5, as added by AB 139 (Stats. 2005, Ch. 74), conformed California law to federal law so that tax practitioners who are suspended or disbarred from practice before the IRS would also be precluded from practicing before the FTB during the period of the federal suspension. The law applies to all final federal notices issued on or after July 19, 2005.

A practitioner who receives a final federal order of suspension or disbarment is required to provide written notification to the FTB within 45 days. The written notification must include an acknowledgement that the federal action is accurate or the reasons that the federal action is clearly erroneous. Failure to meet the 45 day deadline subjects the practitioner to a penalty of \$5,000.

R&TC section 19523.5 requires that the FTB, after providing notice and an opportunity for a proceeding on whether the federal action is clearly erroneous, suspend or disbar persons from practice before the FTB who have been suspended or disbarred from practice before the IRS. The state suspension period ends on the date that the federal suspension period ends.

The proceeding is subject to the requirements of the Administrative Procedure Act (APA) that, among other things, requires an ALJ to preside over the proceeding and the rules of evidence to apply.

Practice (before the FTB) for purposes of R&TC section 19523.5 is defined as all matters connected with a presentation to the FTB or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the FTB.

Presentation includes activities such as preparing and filing documents, corresponding and communicating with the FTB, and representing a client at conferences, hearings, and meetings.

Practitioners who have been suspended or disbarred from practice before the FTB may obtain court review of the determination by filing a petition for a writ of mandate in the superior court. If granted, a writ of mandate would require that the FTB allow the practitioner to continue to practice before the FTB.

Under existing law, the FTB may prescribe any regulations necessary to carry out the purpose of R&TC section 19523.5.

Existing state law prohibits the disclosure of any taxpayer information, except as specifically authorized by statute. Unauthorized disclosure of state tax information is a misdemeanor and unauthorized disclosure of federal tax information is a felony.

Program History/Background

R&TC section 19523.5 was enacted on July 19, 2005, as a result of an FTB sponsored legislative proposal developed in response to then Controller Westly's efforts to address California's tax gap.

During the initial five year period since enactment of the California suspension provision, approximately 139 California practitioners suspended or disbarred from practice before the IRS remain suspended. Of these 139 federal actions involving a California practitioner, 112 were suspended or disbarred as a result of an expedited suspension process, 25 consented to the federal action, and the remaining 2 practitioners were suspended or disbarred by decision of a federal ALJ upon completion of an evidentiary hearing.

The number of California practitioners who have been suspended or disbarred from practice before the IRS since the California suspension provisions were enacted have ranged from a yearly low of 19 during 2008 to a yearly high of 37 in 2006. On average, approximately 28 California practitioners have received a final federal determination annually. Final FTB action on these practitioners is pending.

Problem

This legislative proposal would resolve the following three problems:

1. Current law requires that the FTB provide tax practitioners suspended or disbarred from practicing before the IRS, after the federal government has provided the right to a full evidentiary hearing, an administrative proceeding, subject to all the rules and protections of the California APA, on whether the federal determination was clearly erroneous, which is an overly rigorous proceeding for a hearing of such narrow scope.
2. Current law fails to specify the date that interest begins to accrue on the penalty for failure to notify the FTB timely of a federal suspension or disbarment.
3. Current law fails to provide the FTB express authority to publish the names of suspended or disbarred practitioners, which could lead to the allegation that publication is a disclosure violation under R&TC section 19542.

Proposed Solutions

Amend R&TC section 19523.5 to do each of the following:

1. Recast the proceeding to determine whether the federal determination was clearly erroneous as a hearing before FTB staff that is excluded from the requirements of the APA, including the requirements that an ALJ preside over the hearing and that the rules of evidence apply.
2. Explicitly state the date that interest begins to accrue on the penalty by specifying that the penalty becomes due and payable upon notice and demand by the FTB.
3. Provide express authority for the FTB to publish and maintain a list of practitioners who are currently suspended or disbarred from practice before the FTB, including the suspension period, as a result of an existing federal suspension or disbarment. Practitioners who have been reinstated to practice before the IRS would have their names removed by FTB from the published list by providing a copy of the federal reinstatement notice to the FTB.

Effective/Operative Date of Solution

Assuming enactment during the 2011 legislative session, this proposal would become effective on January 1, 2012, and would be operative as of that date. The changes this proposal would make would apply to final federal orders of suspension or disbarment issued on or after July 19, 2005.

Justification

1. Excluding the existing proceeding from the APA requirements would match the rigor of the hearing procedural requirements to the scope of the proceeding and would eliminate duplication of effort by both the practitioner and the department. A practitioner would still be allowed to petition the court for review of the suspension or disbarment, thus preserving the ability for a practitioner to obtain independent judicial review of the FTB's determination.
2. Specifying the date that the penalty for failure to provide timely notice of a federal suspension or disbarment would become due and payable would eliminate ambiguity in the law as to the date that interest accrual begins and eliminate disputes between penalized practitioners and the department.

3. Express authority for FTB to publish a list of suspended or disbarred practitioners would preclude the argument that publication is a disclosure violation under R&TC section 19542 and is consistent with the intent of R&TC Section 19523.5.

Implementation

Implementing this proposal would include the creation of the hearing process and related notices, letters and instructions, and a one-time system enhancement to modify information systems. These changes are expected to be moderate and would have a minimal impact on the department.

Fiscal Impact

Excluding the required proceeding from the APA requirements so that the hearing would be conducted by the FTB staff rather than an ALJ would reduce departmental costs by an estimated \$140,000 in year one and \$40,000, thereafter.

The cost to create the internal processes to implement this proposal would not significantly affect the department's costs.

Economic Impact

This proposal would not directly impact the state's income tax revenue.

Other States

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Under *Minnesota* law, the state may commence legal action to enjoin a preparer from engaging in specified conduct, or if the court determines that a tax return preparer has continually engaged in the specific conduct and that an injunction prohibiting the specific conduct would be insufficient to prevent the preparer's interference with state tax laws, the court may enjoin that person from acting as a tax preparer in *Minnesota* altogether.

With the exception of the *Minnesota* law authorizing legal action to prevent a preparer from engaging in specified conduct or acting as a tax preparer, no laws comparable to the changes requested in this proposal were identified.

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FRANCHISE TAX BOARD'S
LP A

Section 19523.5 of the Revenue and Taxation Code is amended to read:

(a) If the United States Secretary of the Treasury has, under the authority of Section 330(b) of Subchapter II of Chapter 3 of Subtitle 1 of Title 31 of the United States Code, suspended or disbarred a person from practice before the United States Department of the Treasury, the Franchise Tax Board shall, after notice and opportunity for a proceeding hearing to show that the action of the United States Secretary of the Treasury was clearly erroneous, suspend or disbar that person from practice before the Franchise Tax Board during the period of federal suspension or disbarment, ~~unless the action of the United State Secretary of the Treasury was clearly erroneous.~~ Chapter 4.5 (commencing with Section 11400) of Part 1 of Division 3 of Title 2 of the Government Code does not apply to a hearing under this subdivision.

(b) For purposes of this section, both of the following definitions apply:

(1) "Practice" or "practices" means all matters connected with a presentation to the Franchise Tax Board or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Franchise Tax Board.

(2) "Presentations" means, but is not limited to, preparing and filing documents, corresponding and communicating with the Franchise Tax Board, and representing a client at conferences, hearings, and meetings.

(c) (1) Every person who practices before the Franchise Tax Board and is suspended or disbarred from practice before the United States Department of the Treasury shall notify the Franchise Tax Board, in writing, within 45 days of the issuance of a final order disbaring or suspending the person pursuant to Section 10.80 of Subpart D of Part 10 of Subtitle A of Title 31 of the Code of Federal Regulations, revised as of July 26, 2002.

(2) Any person that fails to notify the Franchise Tax Board pursuant to paragraph (1) shall be subject to a penalty of five thousand dollars (\$5,000). The penalty shall be due and payable upon notice and demand from the Franchise Tax Board.

(d) The written notice required by subdivision (c) shall concede the accuracy of the federal action, or state the reason or reasons why the federal action is clearly erroneous.

(e) Notwithstanding any other provision of law, including Section 6254.21 of the Government Code, the Franchise Tax Board shall make available as a matter of public record, in the time and manner the Franchise Tax Board may determine, a list of persons suspended or disbarred from practice before the Franchise Tax Board pursuant to this section.

(~~e~~f) Any person that has been suspended or disbarred from practice before the Franchise Tax Board may seek review of that determination by bringing an action pursuant to Section 1085 of the Code of Civil Procedure.

(~~f~~g) The Franchise Tax Board may prescribe any regulations necessary to carry out the purposes of this section.

(~~g~~h) This section shall be effective for final federal orders of disbarment or suspension issued on or after the enactment date of ~~this act~~ Chapter 74 of the Statutes of 2005.

(i) The amendments made to this section by the act adding this subdivision shall apply to federal orders of suspension or disbarment issued on or after July 19, 2005.

LP A
Franchise Tax Board (FTB) Suspension Of Practitioner Suspended or Disbarred For Federal
Purposes Clean Up/
Modify Revenue and Taxation Code (R&TC) Section 19523.5
EXHIBIT A

**Volume Of California Practitioners Subject To Suspension Or Disbarment
For The Period July 19, 2005 Through July 16, 2010**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | | |
|-----------------------------|----------|-----------|-----------|-----------|-----------|-----------|------------|------------|
| Consented Suspension | 2 | 3 | 10 | 2 | 3 | 0 | | 20 |
| Expedited Suspension | 6 | 33 | 21 | 16 | 20 | 16 | | 112 |
| Decided Suspension | 0 | 0 | 0 | 1 | 0 | 0 | | 1 |
| Consented Disbarment | 1 | 1 | 2 | 0 | 1 | 0 | | 5 |
| Decided Disbarment | 0 | 0 | 1 | 0 | 0 | 0 | | 1 |
| | | | | | | | | |
| | 9 | 37 | 34 | 19 | 24 | 16 | 139 | 139 |

Consented Suspension: Practitioners in this category may, to avoid the institution or conclusion of a proceeding for disbarment/suspension from practice before the IRS, offer his or her consent to suspension from practice. The Office of Professional Responsibility (OPR) may suspend in accordance with the consent offered.

Expedited Suspension: Practitioners in this category have been immediately suspend from practicing before the IRS because they either, 1) had a license to practice as an attorney, CPA or actuary suspended or revoked for cause or, 2) have been convicted of certain crimes within 5 years from the date the proceeding was instituted.

Decided Suspension: Practitioners in this category have been placed under suspension from practice before the IRS by decision of an administrative law judge

Consented Disbarment: Practitioners in this category have offered their consent to disbarment from practice to avoid the institution or conclusion of a proceeding for disbarment/suspension before the IRS under the OPR's authority to disbar in accordance with the consent offered.

Decided Disbarment: Practitioners in this category have been disbarred from practice before the IRS by decision of an administrative law judge.

LEGISLATIVE PROPOSAL B EXECUTIVE SUMMARY

- **Title:** Exempt Organizations/Filing Fees
- **Problem:** The following problems have been identified in current law:
 1. The fee amounts paid with the application submitted by non-profit organizations to obtain California tax-exempt status is insufficient to cover the department's processing costs,
 2. Certain organizations are exempt from paying the fee for filing the annual information return resulting in inequitable treatment among organizations, and
 3. The annual information return filing fee is due the same date as the extended due date of the return and because this is different from income and franchise administrative tax laws that extend filing due dates but do not extend payment due dates, organizations and tax preparers have different payment rules for tax-exempt and non-tax-exempt entities.
- **Proposed Solution/Justification:** This proposal would reduce state general fund costs by increasing the filing fee to an amount that generally covers the department's administrative costs, would improve efficiencies in the department's tax-exempt organizations program by eliminating the fee exception for certain entities, and would reduce filing complexities for organizations and tax preparers by eliminating payment due date differences.
- **Revenue:** This proposal would result in the following revenue gains:

| Estimated Revenue Impact of LP B Operative Beginning On Or After January 1, 2012 Assumed Enactment September 30, 2011 | | | | |
|---|-------------------|-------------------|-------------------|-------------------|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| Exempt Application Fee Increases | +\$189,000 | +\$474,000 | +\$490,000 | +\$510,000 |
| Removing Exemptions for the Form 199 Filing Fee | +\$415,000 | +\$67,000 | +\$98,000 | +\$134,000 |
| Filing Fee Due Date | +\$257,000 | +\$281,000 | +\$305,000 | +\$331,000 |
| Total Revenue Impact | +\$861,000 | +\$822,000 | +\$893,000 | +\$975,000 |

Title

Exempt Organizations/Filing Fees

Introduction

This proposal would revise the current fee structure both for applications submitted by non-profit organizations to obtain California tax-exempt status and for information returns filed by most tax-exempt organizations.

Current State/Federal Law

Applications for Tax-Exempt Status

Federal and state laws allow non-profit organizations to be exempt from income tax.

Federal Law

Under federal law, a non-profit entity can submit federal Form 1023, 1024, or 1028 with a fee to apply for tax-exempt status. The fee is \$400 for organizations with annual gross receipts less than \$10,000 during the preceding four years or \$850 if the gross receipts are greater than or equal to \$10,000 during the preceding four years.

State Law

To obtain California tax-exempt status, an organization is required to file form FTB 3500, Exemption Application, or form FTB 3500A, Submission of Exemption Request.

- Form FTB 3500 - Organizations that have not obtained federal tax-exempt status file form FTB 3500, along with a \$25 processing fee. An organization obtains tax-exempt status upon receiving a letter from the FTB exempting the organization from tax.
- Form FTB 3500A - Organizations that have obtained federal tax-exempt status¹ file form FTB 3500A. There is no fee for submitting form FTB 3500A, and organizations are tax exempt for state purposes on the same day of the federal tax-exempt determination.

Annual Tax-Exempt Organization Information Return

Federal Law

The IRS requires tax-exempt organizations to file an annual information return to report items such as gross income, receipts, and disbursements. The requirements for filing the annual information return are basically the same for federal and state purposes.

¹ Under Internal Revenue Code section 501(c)(3).

Federal law does not allow the IRS to charge a filing fee, but does assess penalties when returns are filed late. The federal penalty for filing a late or incomplete annual information return is significantly different from California's penalty.

State Law

State law requires exempt organizations to file Form 199, California Exempt Organization Annual Information Return, unless the entity falls under a reporting exception. The return is due along with a \$10 filing fee. The following organizations are excluded from filing an annual information return:

- Religious organizations,
- Governmental entities,
- Pension plans,
- Political organizations, and
- Organizations, except private foundations, that on average have less than \$25,000 in gross receipts.

Exempt organizations that must file an annual information return must also determine if the filing fee must be paid. The following organizations are excluded from the \$10 filing fee under Revenue and Taxation Code (R&TC) section 23722:

- Religious organizations.
- Organizations controlled by religious organizations.
- Certain educational organizations.²
- Charitable organizations.
- Organizations for the prevention of cruelty to children and animals.³

State law provides that organizations required to file an annual information return are subject to the late-filing penalty if the organizations fail to file the return timely. A return and filing fee are considered timely filed if submitted on or before the original or extended due date. The original due date is the 15th day of the fifth month following the end of the organizations' taxable year. The extended due date is six months after the original due date.

Program Background

There are approximately 240,000 exempt organizations registered in California. To obtain tax-exempt status, organizations must submit an application for exemption using form FTB 3500, and for organizations that already have federal tax-exempt status, using form FTB 3500A.

² For the purposes of the exemption from the filing fee, an educational organization is one that normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly performed.

³ The organization must be supported, in whole or in part, by funds contributed by the United States or any state or political subdivision thereof, or is primarily supported by contributions of the general public.

Form FTB 3500A is a short form that simply requires IRS documentation of the organizations' federal tax-exempt status.

The \$25 application fee submitted with form FTB 3500 was established in 1983 and has not been increased since then. There is no fee for submitting form FTB 3500A. During the 2009/2010 fiscal year, the department processed approximately 4,400 forms FTB 3500 and 4,000 forms FTB 3500A.

Of the 240,000 registered California tax-exempt organizations, approximately 142,000 are excused from filing Form 199, because these entities meet one of the filing-fee exceptions listed above. The remaining 98,000 organizations are required to file Form 199 and pay a \$10 filing fee, unless the entity is one of the approximately 23,000 organizations that meet one of the fee exceptions listed above.

The department's costs to process each form FTB 3500 and form FTB 3500A are approximately \$100 and \$35, respectively. The cost for processing each Form 199 is approximately \$7. When the department receives a fee for an exempt application or an information return filing, the department remits that fee to the personal income tax fund for deposit into the general fund.

The department is appropriated the processing costs for administering the tax-exempt organization program through the annual budget process. The department's costs for processing forms FTB 3500, FTB 3500A, and Form 199 during the 2009/2010 fiscal year were approximately \$1.26 million and the total fees collected and remitted to the general fund were approximately \$860,000, resulting in a net cost to the state of approximately \$400,000.

Problem

The following problems have been identified in current law:

1. The fee amounts paid with the application submitted by non-profit organizations to obtain California tax-exempt status is insufficient to cover the department's processing costs;
2. Certain organizations are exempt from paying the fee for filing the annual information return, resulting in inequitable treatment among organizations; and
3. The annual information return filing fee is due the same date as the extended due date of the return and because this is different from income and franchise tax laws that extend filing due dates but do not extend payment due dates, organizations and tax preparers have different payment rules for tax-exempt and non-tax-exempt entities.

Proposed Solution

This proposal would revise current law to allow the FTB to establish regulations to do the following:

1. Increase the fee for submitting form FTB 3500 from \$25 to \$100, impose a new fee of \$35 for submitting form FTB 3500A, and allow the FTB to adjust these fees in the future based on changes to the department's administrative costs of processing these forms;
2. Remove the current Form 1099 fee exemptions for certain entities so that all tax-exempt organizations required to file Form 199 would be required to pay the \$10 filing fee; and allow the FTB to adjust this fee in the future based on changes to the department's administrative costs of processing Form 199; and,
3. Revise the due date for the Form 199 filing fee so that all organizations would be required to pay the filing fee on or before the original due date of Form 199.

Effective/Operative Date of Solution

Assuming enactment during the 2011 legislative session, this proposal would become effective and operative on January 1, 2012, and would apply both to tax-exempt application fees and to annual information return fees required to be paid on or after that date.

Justification

This proposal would reduce state general fund costs by increasing the filing fee to an amount that generally covers the department's administrative costs, would improve efficiencies in the department's tax-exempt organizations program by eliminating the fee exception for certain entities, and would reduce filing complexities for organizations and tax preparers by eliminating payment due date differences.

Implementation

This proposal could be implemented with minimal impact to the department's operations.

Fiscal Impact

The department estimates that costs to modify existing systems and processes to incorporate application and filing fee increases for tax-exempt organizations would be approximately \$65,000 (0.6 P.Y.) in the first year and approximately \$27,000 (0.6 P.Y.) in ongoing years. The increase in departmental costs in the first year (for the same 0.6 P.Y.) is related to overtime that would be required to implement this proposal. A budget change proposal (BCP) would be requested to cover the additional costs to the department.

Economic Impact

| Estimated Revenue Impact of LP B Operative Beginning On Or After January 1, 2012 Assumed Enactment September 30, 2011 | | | | |
|---|-------------------|-------------------|-------------------|-------------------|
| | 2011-12 | 2012-13 | 2013-14 | 2014-15 |
| Exempt Application Fee Increases | +\$189,000 | +\$474,000 | +\$490,000 | +\$510,000 |
| Removing Exemptions for the Form 199 Filing Fee | +\$257,000 | +\$281,000 | +\$305,000 | +\$331,000 |
| Filing Fee Due Date | +\$415,000 | +\$67,000 | +\$98,000 | +\$134,000 |
| Total Revenue Impact | +\$861,000 | +\$822,000 | +\$893,000 | +\$975,000 |

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion:

The revenue impact for this proposal would be derived from the following three sources:

1. Increases in the fees for processing forms FTB 3500 and FTB 3500A;
2. Fee revenue from entities that would no longer be exempt from the Form 199 filing fee; and
3. An acceleration of revenue for taxpayers that would be required to pay the Form 199 filing fee by the original due date instead of the extended due date.

1. Exempt Application Fee Increases

This proposal would increase the fee for form FTB 3500 by \$75 (from \$25 to \$100) and institute a fee for form FTB 3500A of \$35. In fiscal year 2009/10, the FTB received approximately 4,400 forms FTB 3500 and 4,000 forms FTB 3500A. These volumes were grown at their previous year's growth rates of -6 percent and 10 percent, respectively. As such, the fee increases for 2012 are estimated to be approximately \$475,000 $\{[4,400 \text{ forms FTB 3500} \times (1-6\%) \times \$75] + [4,000 \text{ forms FTB 3500} \times (1+10\%) \times \$35]\}$ in fiscal year 2012/13. It is assumed that the fee amounts for forms submitted on or after January 1, 2013, would grow at the same rate as the California Consumer Price Index.

2. Removing Exemptions for the Form 199 Filing Fee

In fiscal year 2009/10, there were approximately 23,000 organizations that were exempt from paying the \$10 Form 199 filing fee. This proposal would remove the filing-fee exemption. Assuming a growth rate of 6 percent and the filing fee remaining at \$10, there would be a revenue gain of approximately \$281,000 $[(23,000 \times ((1+6\%) \times (1+6\%) \times (1+6\%))) \times \$10]$ in fiscal year 2012-13.

3. Filing Fee Due Date

The FTB received about 74,500 Forms 199 in fiscal year 2009-10. Department staff determined that 86 percent of these were filed between the due date and the extended due date. It was also determined that 67 percent are from calendar year filers and 33 percent are fiscal year filers. The number of forms filed has increased approximately 6 percent in each of the last two years.

Of the calendar year and fiscal year filers, we estimate that approximately \$450,000 of revenue will be accelerated from 2013-14 into 2012-13 and approximately \$415,000 will be accelerated from 2012-13 to 2011-12. The \$35,000 difference is added to the \$31,000 resulting from the change in the CPI, which increases revenue for the 2012-13 fiscal year.

Similarly, the approximately \$415,000 accelerated from 2012-13 to 2011-12 represents the increased revenue for the 2011-12 fiscal year. This acceleration of payments has a much larger impact during 2011-12, the first year of the proposal, because revenue would not be accelerated into 2010-11.

Other States

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

These states follow the IRS's determination for an entity's tax-exempt status. *Illinois* has a free application process for obtaining tax-exempt status, but still follows the IRS's tax-exempt determination. None of the other states listed above impose a fee or require any submission to be eligible for tax-exempt status for state income tax purposes.

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FRANCHISE TAX BOARD'S
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AMENDMENT 1

SECTION 1. Section 19591 of the Revenue and Taxation Code shall be amended to read:

19591. (a) Specialized tax services fees shall be imposed upon the following services provided by the board:

- (1) Installment payment programs.
- (2) Expedited services for:
 - (A) Corporation revivor requests.
 - (B) Tax clearance certificate requests.
 - (C) Tax-exempt status requests.
 - (D) Limited partnership revival confirmation letter requests.
- (3) Filing fees for:

- (A) Application for exemption under Section 23701.
- (B) Submission of exemption under Section 23701d.
- (C) Annual return required under Section 23722.

(b) (1) For periods on or after the effective date of this section and prior to January 1, 2006, the Franchise Tax Board shall publish by notice a schedule of specialized tax services fees to be imposed, which notice shall be exempt from the requirements of Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government **Code**. The amounts of these fees under this paragraph shall be calculated in the same general manner as required under paragraph (2).

(2) Commencing on January 1, 2006, the amount of the specialized tax services fees shall be established by the board through regulations adopted pursuant to Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government **Code**, and shall be established in the manner and in the amounts necessary to reimburse the board for the costs of administering the specialized services, including the board's direct and indirect costs for providing specialized tax services.

(3) For periods on or after the effective date of this section, and prior to January 1, 2011, the amount of the specialized tax service fee for limited partnership revival confirmation letter requests shall be one hundred dollars (\$100). Commencing on January 1, 2011, the specialized tax service fee for limited partnership revival confirmation letter requests shall be calculated in the same general manner as required under paragraph (2).

(4) (A) For periods on or after the effective date of this section and prior to January 1, 2013, the filing fees under paragraph (3) of subdivision (a) shall be:

(i) One hundred dollars (\$100) for the application for exemption under Section 23701.

(ii) Thirty-five dollars (\$35) for the submission of exemption under Section 23701d.

(iii) Ten dollars (\$10) for the annual return required under Section 23722.

(B) Commencing on January 1, 2013, the amount of the filing fees under paragraph (3) of subdivision (a) shall be calculated in the same general manner as required under paragraph (2).

AMENDMENT 2

SEC. 2. Section 23701 of the Revenue and Taxation Code shall be amended to read:

23701. Organizations which are organized and operated for nonprofit purposes within the provisions of a specific section of this article, or are defined in Section 23701h (relating to certain title-holding companies) or Section 23701x (relating to certain title-holding companies), are exempt from taxes imposed under this part, except as provided in this article or in Article 2 (commencing with Section 23731) of this chapter, if:

(a) An application for exemption is submitted in the form prescribed by the Franchise Tax Board; and

(b) A filing fee, as determined under subdivision (b) of Section 19591, ~~of twenty-five dollars (\$25)~~ is paid with each application for exemption filed with the Franchise Tax Board after December 31, 1969; and

(c) The Franchise Tax Board issues a determination exempting the organization from tax.

This section shall not prevent a determination from having retroactive effect and does not prevent the issuance of a determination with respect to a domestic organization which was in existence prior to January 1, 1970, and exempt under prior law without the submission of a formal application or payment of a filing fee. For the purpose of this section, the term "domestic" means created or organized under the laws of this state.

The Franchise Tax Board may issue rulings and regulations as are necessary and reasonable to carry out the provisions of this article.

AMENDMENT 3

SEC. 3. Section 23701d of the Revenue and Taxation Code shall be amended to read:

23701d. (a) A corporation, community chest or trust, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involved the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda or otherwise attempting to influence legislation, (except as otherwise provided in Section 23704.5), and which does not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. An organization is not organized exclusively for exempt purposes listed above unless its assets are irrevocably dedicated to one or more purposes listed in this section. Dedication of assets requires that in the event of dissolution of an organization or the impossibility of performing the specific organizational purposes the assets would continue to be devoted to exempt purposes. Assets shall be deemed irrevocably dedicated to exempt purposes if the articles of organization provide that upon dissolution the assets will be distributed to an organization which is exempt under this section or Section 501(c)(3) of the Internal Revenue **Code** or to the federal government, or to a state or local government for public purposes; or by a provision in the articles of organization, satisfactory to the Franchise Tax Board; that the property will be distributed in trust for exempt purposes; or by establishing that the assets are irrevocably dedicated to exempt purposes by operation of law. The irrevocable dedication requirement shall not be a sole basis for revocation of an exempt determination made by the Franchise Tax Board prior to the effective date of this amendment.

(b) (1) In the case of a qualified amateur sports organization--

(A) The requirement of subdivision (a) that no part of its activities involves the provision of athletic facilities or equipment shall not apply.

(B) That organization shall not fail to meet the requirements of subdivision (a) merely because its membership is local or regional in nature.

(2) For purposes of this subdivision, "qualified amateur sports organization" means any organization organized and operated exclusively to foster national or international amateur sports competition if that organization is also organized and operated primarily to conduct national or international competition in sports or to support and develop amateur athletes for national or international competition in sports.

(c) (1) Notwithstanding subdivisions (a), (b), and (c) of Section **23701**, an organization organized and operated for nonprofit purposes in accordance with this section shall be exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731), upon its submission to the Franchise Tax Board of one of the following:

(A) A copy of the determination letter or ruling issued by the Internal Revenue Service recognizing the organization's exemption from federal income tax under Section 501(a) of the Internal Revenue **Code**, as an organization described in Section 501(c)(3) of the Internal Revenue **Code**.

(B) A copy of the group exemption letter issued by the Internal Revenue Service that states that both the central organization and all of its subordinates are tax-exempt under Section 501(c)(3) of the Internal Revenue **Code** and substantiation that the organization is included in the federal group exemption letter as a subordinate organization.

(2) Upon receipt of the documents required in subparagraph (A) or (B) of paragraph (1), the Franchise Tax Board shall issue an acknowledgment that the organization is exempt from taxes imposed by this part, except as provided in this article or in Article 2 (commencing with Section 23731). The acknowledgment may refer to the organization's recognition by the Internal Revenue Service of exemption from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue **Code** and, if applicable, the organization's subordinate organization status under a federal group exemption letter. The effective date of an organization's exemption from state income tax pursuant to this subdivision shall be no later than the effective date of the organization's recognition of exemption from federal income tax as an organization described in Section 501(c)(3) of the Internal Revenue **Code**, or its status as a subordinate organization under a federal group exemption letter, as applicable.

(3) If, for federal income tax purposes, an organization's exemption from tax as an organization described in Section 501(c)(3) of the Internal Revenue **Code** is suspended or revoked, the organization shall notify the Franchise Tax Board of the suspension or revocation, in the form and manner prescribed by the Franchise Tax Board. Upon notification, the board shall suspend or revoke, whichever is applicable, for state income tax purposes, the organization's exemption under paragraph (1) of this subdivision.

(4) This subdivision shall not be construed to prevent the Franchise Tax Board from revoking the exemption of an organization that is not organized or operated in accordance with this chapter or Section 501(c)(3) of the Internal Revenue **Code**.

(5) If the Franchise Tax Board suspends or revokes the exemption of an organization pursuant to paragraph (3) or (4), the exemption shall be reinstated only upon compliance with Section **23701**, regardless of whether the organization can establish exemption under paragraph (1).

(C) A filing fee, as determined under subdivision (b) of Section 19591, is paid with each submission of exemption request filed with the Franchise Tax Board.

(d) The Franchise Tax Board may prescribe rules and regulations to implement this section.

AMENDMENT 4

SEC. 4. Section 23722 of the Revenue and Taxation is amended to read:

23772. (a) For the purposes of this part--

(1) Except as provided in paragraph (2), every organization exempt from taxation under Section 23701 and every trust treated as a private foundation because of Section 4947(a)(1) of the Internal Revenue Code shall file an annual return, stating specifically the items of gross income, receipts, and disbursements, and any other information for the purpose of carrying out the laws under this part as the Franchise Tax Board may by rules or regulations prescribe, and shall keep any records, render under oath any statements, make any other returns, and comply with any rules and regulations as the Franchise Tax Board may from time to time prescribe. The return shall be filed on or before the 15th day of the fifth full calendar month following the close of the taxable year.

(2) Exceptions from filing--

(A) Mandatory exceptions--Paragraph (1) does not apply to--

(i) Churches, their integrated auxiliaries, and conventions or association of churches,

(ii) Any organization (other than a private foundation as defined in Section 23709), the gross receipts of which in each taxable year are normally not more than twenty-five thousand dollars (\$25,000), or

(iii) The exclusively religious activities of any religious order.

(B) Discretionary exceptions--The Franchise Tax Board may permit the filing of a simplified return for organizations based on either gross receipts or total assets or both gross receipts and total assets, or may permit the filing of an information statement (without fee), or may permit the filing of a group return for incorporated or unincorporated branches of a state or national organization where it determines that an information return is not necessary to the efficient administration of this part.

(3) An organization that is required to file an annual information return shall pay a filing fee ~~of ten dollars (\$10), as determined under subdivision (b) of Section 19591, on or before the original due date for filing the annual information return~~ ~~(determined with regard to any extension of time for filing the return)~~ required by this section. In case of failure to pay the fee on or before the due date, unless it is shown that the failure is due to reasonable cause, the filing fee shall be twenty-five dollars (\$25). All collection remedies provided in Article 5 (commencing with Section 18661) of Chapter 2 of Part 10.2 are applicable to collection of the filing fee. ~~However, the filing fee does not apply to the organization described in paragraph (4).~~

~~(4) Paragraph (3) does not apply to: (A) a religious organization exempt under Section 23701d; (B) an educational organization exempt under Section 23701d, if that organization normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (C) a charitable organization, or an organization for the prevention of cruelty to children or animals, exempt under Section 23701d, if that organization is supported, in whole or in part, by funds contributed by the United States or any state or political subdivision thereof, or is primarily supported by contributions of the general public; (D) an organization exempt under Section 23701d, if that organization is operated, supervised, or controlled by or in connection with a religious organization described in subparagraph (A).~~

(b) Every organization described in Section 23701d that is subject to the requirements of subdivision (a) is required to furnish annually information, at the time and in the manner as the Franchise Tax Board may by rules or regulations prescribe, setting forth all of the following:

(1) Its gross income for the year.

(2) Its expenses attributable to gross income and incurred within the year.

(3) Its disbursements within the year for the purposes for which it is exempt.

(4) A balance sheet showing its assets, liabilities, and net worth as of the beginning of that year.

(5) The total of the contributions and gifts received by it during the year, and the names and addresses of all substantial contributors.

(6) The names and addresses of its foundation manager (within the meaning of Section 4946 of the Internal Revenue Code) and highly compensated employees.

(7) The compensation and other payments made during the year to each individual described in paragraph (6).

(8) In the case of an organization with respect to which an election under Section 23704.5 is effective for the taxable year, the following amounts for that organization for that taxable year:

(A) The lobbying expenditures (as defined in Section 4911(c)(1) of the Internal Revenue Code).

(B) The lobbying nontaxable amount (as defined in Section 4911(c)(2) of the Internal Revenue Code).

(C) The grassroots expenditures (as defined in Section 4911(c)(3) of the Internal Revenue Code).

(D) The grassroots nontaxable amount (as defined in Section 4911(c)(4) of the Internal Revenue Code). For purposes of this paragraph, if Section 23740 applies to the organization for the taxable year, the organization shall furnish the amounts with respect to the affiliated group as well as with respect to the organization.

(9) Other information with respect to direct or indirect transfers to, and other direct or indirect transactions and relationships with, other organizations described in Sections 23701a to 23701w, inclusive (other than Sections 23701d, 23701k, and 23701t), as the Franchise Tax Board may require to prevent either of the following:

(A) Diversion of funds from the organization's exempt purpose.

(B) Misallocation of revenue or expense.

(10) Any other relevant information as the Franchise Tax Board may prescribe.

(c) For the purposes of this part--

(1) In the case of a failure to file a return required under this section on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that the failure is due to reasonable cause, there shall be paid (on notice and demand by the Franchise Tax Board and in the same manner as tax) by the exempt organization or trust failing so to file, five dollars (\$5) for each month or part thereof during which the failure continues, but the total amount imposed hereunder on any organization for failure to file any return may not exceed forty dollars (\$40).

(2) The Franchise Tax Board may make written demand upon a private foundation failing to file under paragraph (1) of this subdivision specifying therein a reasonable future date by which the filing shall be made, and if the filing is not made on or before that date, and unless it is shown that failure so to file is due to reasonable cause, there shall be paid (on notice and demand by the Franchise Tax Board and in the same manner as tax) by the person failing so to file, in addition to the penalty prescribed in paragraph (1), a penalty of five dollars (\$5) each month or part thereof after the expiration of the time specified in the written demand during which the failure continues, but the total amount imposed hereunder on all persons for the failure to file shall not exceed twenty-five dollars (\$25). If more than one person is liable under this paragraph for a failure to file, all of those persons shall be jointly and severally liable with respect to the failure. The term "person" as used herein means any officer, director, trustee, employee, member, or other individual who is under a duty to perform the act in respect of which the violation occurs.

LEGISLATIVE PROPOSAL C

EXECUTIVE SUMMARY

- **Title:** Transfer the Collection of Department of Industrial Relations (DIR) Debts from the Franchise Tax Board (FTB) to the Employment Development Department (EDD)
- **Problem:** In anticipation of the obsolescence of the FTB's DIR collection application, recently enacted legislation, SB 856 (Stats. 2010, Ch. 719, Senate Committee on Budget and Fiscal Review), authorizes EDD to collect DIR debts, but fails to repeal the FTB's current mandate to collect the same debts.
- **Proposed Solution/Justification:** Repeal the statutory mandate for the FTB to collect DIR debts. Continuing to utilize the obsolete DIR collection application carries the following risks:
 - The vendor discontinued support of collection application so that the vendor is no longer obligated to ensure that the system will function properly when normal hardware and software infrastructure upgrades are performed, to evaluate the system for security vulnerabilities, or to provide security patches for known problems.
 - The ongoing migrating of FTB computers to Windows 7 will cause the DIR collection application to be incompatible with FTB's basic operating system.
- **Revenue:** This proposal would not impact state income tax revenues. DIR cases now collected by the FTB will be transferred to and collected by the EDD. The funds collected from DIR cases are distributed by DIR to claimants for outstanding back wages, to special funds at DIR, and to the General Fund.

Title

Franchise Tax Board (FTB) Collection of Industrial Health & Services Debts/Transfer to EDD

Introduction

This proposal would repeal the FTB's statutory mandate to collect debts for the Department of Industrial Relations (DIR) because collection authority for these debts and a new collection system has been given to the Employee Development Department (EDD).

Current State Law

DIR issues wage, fee, and penalty assessments for violations of labor laws and health and safety violations. Since 1995, state law has provided the FTB with mandate to collect debts for DIR. The law permits these debts to be collected in the same manner as personal income tax liabilities, which includes attaching bank accounts and garnishing wages. DIR is required to reimburse the FTB for the actual costs to collect DIR debts, not to exceed a cumulative maximum set by contract. The current contract maximum for fiscal year 2010/11 is \$500,040.

Recently enacted legislation, SB 856 (Stats. 2010, Ch. 719, Senate Committee on Budget and Fiscal Review), authorizes EDD to collect debts for DIR also.

Program Background

In fiscal year 2009-10, the most recent year for which data is available, the FTB's DIR inventory consisted of 9,250 delinquent cases for which over \$4.1 million was collected. The FTB's DIR collection staff consists of one permanent collector and two temporary positions. The FTB's collection staff is trained in the collection of both tax and non-tax debt collections, which allows staff to easily transition between collection workloads.

The FTB's DIR collection cases reside in a debt collection application that is technologically obsolete and no longer supported by the vendor. The DIR collection application requires that DIR cases be entered manually into the system and that demand notices, bank levies, and payments be processed manually by department staff.

On September 3, 2009, EDD's Automated Collection Enhancement System (ACES) Project¹ was awarded to FAST Enterprises. The estimated total project cost is \$93.1 million with full implementation to be completed by January 2, 2011.

¹ http://www.cio.ca.gov/Government/IT_Policy/pdf/7100-189_SPR1.pdf#search=ACES&view=FitH&pagemode=none

Problem

In anticipation of the obsolescence of the FTB's DIR collection application, recently enacted legislation, SB 856 (Senate Committee on Budget and Fiscal Review), authorizes EDD to collect DIR debts, but failed to repeal the FTB's mandate to collect the same debts.

Proposed Solution

Repeal the statutory mandate for the FTB to collect DIR debts and revise the priority of the application of payments from DIR debts collected.

Effective/Operative Date of Solution

If enacted in 2011, this proposal would become effective January 1, 2012, and would be operative as of that date. The department would work together with DIR to identify and resolve any outstanding collection efforts that remain after that date.

Justification

Continuing to utilize a collection application that is obsolete carries high risks for the FTB. The vendor discontinued support of the DIR collection application database management system and associated tools in September 1999, which means the vendor is no longer obligated to ensure that the collection system will function properly when normal hardware and software infrastructure upgrades are performed. The vendor also is no longer responsible for evaluating the database management application and associated tools for security vulnerabilities or providing security patches for known problems.

The department's ability to maintain the DIR collection application is diminishing for two additional reasons. First, due to attrition of technical support staff with historical product knowledge, few staff remain who have the ability to work on the application. Second, the FTB has been migrating to the Windows 7 operating system, which will cause the DIR collection application to be incompatible FTB's basic operating system.

Implementation

Implementation would occur during the department's normal annual update.

Fiscal Impact

This proposal would not impact the FTB's costs because DIR currently reimburses the FTB for the costs of collecting DIR debts. Once collection responsibility is transferred completely to EDD, the FTB's staff working on DIR collections would be redirected to other budgeted positions within the FTB.

Economic Impact

This proposal would not impact state income tax revenues. The DIR cases now collected by the FTB will be transferred to and collected by EDD. The funds collected from the DIR cases are distributed by DIR to claimants for outstanding back wages, to special funds at DIR, and to the General Fund.

Other Agency/Industry Impacted

As of now, EDD's ACES project is currently on schedule. If the ACES project stays on schedule, there would be no impact to DIR by this proposal.

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FRANCHISE TAX BOARD'S
LP C

AMENDMENT 1

SEC. XX Article 6 (commencing with Section 19290) of Chapter 5 of Part 10.2 of Division 2 of the Revenue and Taxation Code is repealed.

~~Article 6 Collections for the Department of Industrial Relations~~

~~**19290.** (a) The Department of Industrial Relations shall enter into an agreement with the Franchise Tax Board that transfers responsibility from the department to the Franchise Tax Board for the collection of delinquent fees, wages, penalties, and costs, and any interest thereon, effective July 1, 1995. Under the agreement, the Franchise Tax Board shall collect unsatisfied judgments that are issued pursuant to Sections 98.2, 226.5, 1023, 1289, 2681, and 6650 of the Labor Code. The agreement shall also provide for the collection of delinquent debts that result from a final determination by the department after the exhaustion of appeal remedies pursuant to Sections 98.3, 210, 1174.5, 1193.6, 1194, 1194.2, 1197.1, 1197.5, 1771, 1774, 3722, 7314, 7350, 7721, and 7904 of the Labor Code. The agreement shall specify the terms under which fees, wages, penalties, and costs, and any interest thereon, become subject to collection by the Franchise Tax Board.~~

~~— The agreement may also provide for reimbursement to the Franchise Tax Board on the basis of a percentage of the amount of revenue realized as a result of the Franchise Tax Board's services, provided that the amount of any reimbursement shall not exceed the actual costs of collection, including court costs and reasonable attorney's fees. Wherever possible the collection costs shall be borne by the judgment debtor. Any fee for the recovery of wages shall not be paid by the workers. The department shall adopt rules and regulations to provide for a reasonable fee to cover actual collection costs. The Franchise Tax Board shall be entitled to court costs and reasonable attorney's fees as a judgment creditor under subdivision (i) of Section 98.2 of the Labor Code.~~

~~— (b) Upon written notice to the obligor from the Franchise Tax Board, any amount referred to the Franchise Tax Board under subdivision (a) and any interest thereon, including any interest on the amount referred under subdivision (a) that accrued prior to the date of referral and any fee imposed to cover collection costs as provided under subdivision (a), shall be treated as final and due and payable to the State of California, and shall be collected from the obligor by the Franchise Tax Board in any manner authorized under the law for collection of a delinquent personal income tax liability, including, but not limited to, issuance of an order and levy under Article 4 (commencing with Section 706.070) of Chapter 5 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure, in the manner~~

~~provided for earnings withholding orders for taxes.~~

~~— (c) (1) Part 10 (commencing with Section 17001), this part, Part 10.7 (commencing with Section 21001), and Part 11 (commencing with Section 23001) shall apply to amounts referred under this article in the same manner and with the same force and effect and to the full extent as if the language of those laws had been incorporated in full into this article, except to the extent that any provision is either inconsistent with this article or is not relevant to this article.~~

~~— (2) Any information, information sources, or enforcement remedies and capabilities available to the agency referring the amount due described in subdivision (a), shall be available to the Franchise Tax Board to be used in conjunction with, or independent of, the information, information sources, or remedies and capabilities available to the Franchise Tax Board for purposes of administering Part 10 (commencing with Section 17001), this part, Part 10.7 (commencing with Section 21001), or Part 11 (commencing with Section 23001).~~

~~— (d) The activities required to implement and administer this part shall not interfere with the primary mission of the Franchise Tax Board to administer Part 10 (commencing with Section 17001) and Part 11 (commencing with Section 23001).~~

~~— (e) For amounts referred for collection under subdivision (a), interest shall accrue at the greater of the rate applicable to the amount due being collected or the rate provided under Section 19521. When notice of the amount due includes interest and is mailed to the obligor, and the amount is paid within 15 days after the date of notice, interest shall not be imposed for the period after the date of notice.~~

~~— (f) In no event shall a collection under this article be construed as a payment of income taxes imposed under Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001).~~

~~— (g) The amendments made by the act adding this subdivision are operative for notices issued on or after January 1, 1998.~~

9290.1. ~~(a) Except as otherwise provided by this section, Section 19290 shall apply to assessments and penalties that are referred to the Franchise Tax Board for collection pursuant to Section 62.9 of the Labor Code. These assessments and penalties shall be deemed for this purpose to be delinquent debts. The collection agreement described in Section 19290 may be amended to include these assessments and penalties, or a separate agreement may be entered into under that section to collect the assessments and penalties. All payments collected by the Franchise Tax Board pursuant to this section shall be deposited in the Cal-OSHA Targeted Inspection and Consultation Fund.~~

~~— (b) In the event that an employer, against whom assessments and penalties as described in subdivision (a) have been levied, notifies the Franchise Tax Board that there is a disagreement as to the amount that is due and subject to collection, the Franchise Tax Board may refer the employer to the Department of Industrial Relations, return the account to the department, or rescind any collection action that may have been taken by the board.~~

~~— (c) The Franchise Tax Board shall provide the Department of Industrial Relations with activity reports, no less frequently than on a quarterly basis, identifying the total amount referred for collection pursuant to Section 62.9 of the Labor Code, the amount collected from each employer, and the board's actual costs of collection. Upon appropriation by the Legislature, the board shall be reimbursed from the Cal-OSHA Targeted Inspection and Consultation~~

~~Fund for its actual costs of collection.~~

~~— (d) Notwithstanding any other provision of law, no interest shall be charged on any assessment or penalty as described in subdivision (a).~~

AMENDMENT 2

Sec. XX. Section 19533 of the Revenue and Taxation Code is amended to read:

19533. In the event the debtor has more than one debt being collected by the Franchise Tax Board and the amount collected by the Franchise Tax Board is insufficient to satisfy the total amount owing, the amount collected shall be applied in the following priority:

~~(a) Payment of any delinquencies transferred for collection under Article 5 (commencing with Section 19270) of Chapter 5.~~

~~(b)~~ (a) Payment of any taxes, additions to tax, penalties, interest, fees, or other amounts due and payable under Part 7.5 (commencing with Section 13201), Part 10 (commencing with Section 17001), Part 11 (commencing with Section 23001), or this part, and amounts authorized to be collected under Section 19722.

~~(c) Payment of delinquent wages collected pursuant to the Labor Code.~~

~~(d)~~ (b) Payment of delinquencies collected under Section 10878.

~~(e)~~ (c) Payment of any amounts due that are referred for collection under Article 5.5 (commencing with Section 19280) of Chapter 5.

~~(f) Payment of any amounts that are referred for collection pursuant to Section 62.9 of the Labor Code.~~

~~(g) Payment of delinquent penalties collected for the Department of Industrial Relations pursuant to the Labor Code.~~

~~(h) Payment of delinquent fees collected for the Department of Industrial Relations pursuant to the Labor Code.~~

~~(i) Payment of delinquencies referred by the Student Aid Commission.~~

~~(j)~~ (d) Notwithstanding the payment priority established by this section, voluntary payments designated by the taxpayer as payment for a personal income tax liability or as a payment on amounts authorized to be collected under Section 19722, shall not be applied pursuant to this priority, but shall instead be applied as designated.

AMENDMENT 3

SEC. XX. Section 62.9 of the Labor Code is amended to read:

62.9. (a) (1) The director shall levy and collect assessments from employers in accordance with this section. The total amount of the assessment collected shall be the amount determined by the director to be necessary to produce the revenue sufficient to fund the programs specified by Section 62.7, except that the amount assessed in any year for those purposes shall not exceed 50 percent of the amounts appropriated from the General Fund for the support of the occupational safety and health program for the 1993-94 fiscal year, adjusted for inflation. The director also shall include in the total assessment amount the department's costs for administering the assessment, including the collections process and the cost of reimbursing the ~~Employment Development Department Franchise Tax Board or another agency or department~~ for its cost of collection activities pursuant to subdivision (c).

(2) The insured employers and private sector self-insured employers that, pursuant to subdivision (b), are subject to

assessment shall be assessed, respectively, on the basis of their annual payroll subject to premium charges or their annual payroll that would be subject to premium charges if the employer were insured, as follows:

(A) An employer with a payroll of less than two hundred fifty thousand dollars (\$250,000) shall be assessed one hundred dollars (\$100).

(B) An employer with a payroll of two hundred fifty thousand dollars (\$250,000) or more, but not more than five hundred thousand dollars (\$500,000), shall be assessed two hundred dollars (\$200).

(C) An employer with a payroll of more than five hundred thousand dollars (\$500,000), but not more than seven hundred fifty thousand dollars (\$750,000), shall be assessed four hundred dollars (\$400).

(D) An employer with a payroll of more than seven hundred fifty thousand dollars (\$750,000), but not more than one million dollars (\$1,000,000), shall be assessed six hundred dollars (\$600).

(E) An employer with a payroll of more than one million dollars (\$1,000,000), but not more than one million five hundred thousand dollars (\$1,500,000), shall be assessed eight hundred dollars (\$800).

(F) An employer with a payroll of more than one million five hundred thousand dollars (\$1,500,000), but not more than two million dollars (\$2,000,000), shall be assessed one thousand dollars (\$1,000).

(G) An employer with a payroll of more than two million dollars (\$2,000,000), but not more than two million five hundred thousand dollars (\$2,500,000), shall be assessed one thousand five hundred dollars (\$1,500).

(H) An employer with a payroll of more than two million five hundred thousand dollars (\$2,500,000), but not more than three million five hundred thousand dollars (\$3,500,000), shall be assessed two thousand dollars (\$2,000).

(I) An employer with a payroll of more than three million five hundred thousand dollars (\$3,500,000), but not more than four million five hundred thousand dollars (\$4,500,000), shall be assessed two thousand five hundred dollars (\$2,500).

(J) An employer with a payroll of more than four million five hundred thousand dollars (\$4,500,000), but not more than five million five hundred thousand dollars (\$5,500,000), shall be assessed three thousand dollars (\$3,000).

(K) An employer with a payroll of more than five million five hundred thousand dollars (\$5,500,000), but not more than seven million dollars (\$7,000,000), shall be assessed three thousand five hundred dollars (\$3,500).

(L) An employer with a payroll of more than seven million dollars (\$7,000,000), but not more than twenty million dollars (\$20,000,000), shall be assessed six thousand seven hundred dollars (\$6,700).

(M) An employer with a payroll of more than twenty million dollars (\$20,000,000) shall be assessed ten thousand dollars (\$10,000).

(b) (1) In the manner as specified by this section, the director shall identify those insured employers having a workers' compensation experience modification rating of 1.25 or more, and private sector self-insured employers having an equivalent experience modification rating of 1.25 or more as determined pursuant to subdivision (e).

(2) The assessment required by this section shall be levied annually, on a calendar year basis, on those insured employers and private sector self-insured employers, as identified pursuant to paragraph (1), having the highest workers' compensation experience modification ratings or equivalent experience modification ratings, that the director determines to be required numerically to produce

the total amount of the assessment to be collected pursuant to subdivision (a).

(c) The director shall collect the assessment from insured employers as follows:

(1) Upon the request of the director, the Department of Insurance shall direct the licensed rating organization designated as the department's statistical agent to provide to the director, for purposes of subdivision (b), a list of all insured employers having a workers' compensation experience rating modification of 1.25 or more, according to the organization's records at the time the list is requested, for policies commencing the year preceding the year in which the assessment is to be collected.

(2) The director shall determine the annual payroll of each insured employer subject to assessment from the payroll that was reported to the licensed rating organization identified in paragraph (1) for the most recent period for which one full year of payroll information is available for all insured employers.

(3) On or before September 1 of each year, the director shall determine each of the current insured employers subject to assessment, and the amount of the total assessment for which each insured employer is liable. The director immediately shall notify each insured employer, in a format chosen by the insurer, of the insured's obligation to submit payment of the assessment to the director within 30 days after the date the billing was mailed, and warn the insured of the penalties for failure to make timely and full payment as provided by this subdivision.

(4) The director shall identify any insured employers that, within 30 days after the mailing of the billing notice, fail to pay, or object to, their assessments. The director shall mail to each of these employers a notice of delinquency and a notice of the intention to assess penalties, advising that, if the assessment is not paid in full within 15 days after the mailing of the notices, the director will levy against the employer a penalty equal to 25 percent of the employer's assessment, ~~and will refer the assessment and penalty to the Franchise Tax Board or another agency for collection.~~ The notices required by this paragraph shall be sent by United States first-class mail.

(5) If an assessment is not paid by an insured employer within 15 days after the mailing of the notices required by paragraph (4), the director shall refer the delinquent assessment and the penalty to ~~the Franchise Tax Board, or another agency, as deemed appropriate by the director, for collection pursuant to Section 19290.1 of the Revenue and Taxation Code.~~

(d) The director shall collect the assessment directly from private sector self-insured employers. The failure of any private sector self-insured employer to pay the assessment as billed constitutes grounds for the suspension or termination of the employer's certificate to self-insure.

(e) The director shall adopt regulations implementing this section that include provision for a method of determining experience modification ratings for private sector self-insured employers that is generally equivalent to the modification ratings that apply to insured employers and is weighted by both severity and frequency.

(f) The director shall determine whether the amount collected pursuant to any assessment exceeds expenditures, as described in subdivision (a), for the current year and shall credit the amount of any excess to any deficiency in the prior year's assessment or, if there is no deficiency, against the assessment for the subsequent year.

TAXPAYER PROPOSAL D

EXECUTIVE SUMMARY

- **Title:** Disaster Loss Deduction/Automatic Disaster Tax Relief
- **Problem:** Because disaster loss bills are frequently signed into law at the end of a legislative year, which is mid-October, and disaster loss elections must be made by October 15, taxpayers frequently have an unreasonably short time to prepare an amended return and are uncertain whether they will receive the intended tax relief.
- **Proposed Solution/Justification:** Make income tax disaster loss treatment automatic when the Governor proclaims a state of emergency related to a Presidentially-declared or Governor-only proclaimed disaster.

This proposal would eliminate the hurdle of enactment of legislation before income tax relief is available to victims of a disaster by allowing these victims a reasonable time to prepare and file an amended return to claim relief.

- **Revenue:** This proposal would have the following revenue impact:

| Estimated Revenue Impact of TP D Tax Years Beginning On Or After January 1, 2012 Enactment Assumed by September 30, 2011 Assumed \$10 Million of Annual Uninsured Loss | | | |
|--|-------------|------------|-----------|
| 2010-11 | 2011-12 | 2012-13 | 2013-14 |
| \$0 | (\$150,000) | (\$50,000) | +\$90,000 |

Title

Disaster Loss Deduction/Automatic Disaster Tax Relief

Introduction

This proposal would make disaster tax relief automatic when the Governor proclaims a state of emergency as a result of a disaster.

Current Federal/State Law

Disaster Losses and Casualty Losses

Under federal law, a disaster loss is defined as business or personal property that is completely or partially destroyed as a result of a fire, storm, flood, or other natural event in an area declared to be a disaster area by the President of the United States. For state purposes, a disaster loss is defined the same as federal law, but is from an event declared to be a disaster area by the President of the United States or the Governor or both.

A casualty loss is defined as the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

Disaster Loss Treatment

Existing federal and state laws allow an individual taxpayer with a disaster loss that is not reimbursed by insurance or otherwise to deduct such losses to the extent that each loss exceeds \$100 and the loss amount exceeds 10 percent of adjusted gross income (AGI).¹ Additionally, disaster loss treatment allows a taxpayer to make an election to claim the disaster loss by filing an amended return for the taxable year prior to the loss to receive a refund more quickly.

Under existing federal law, the deadline to make a disaster loss election to file a prior-year amended return is the due date to file an original return for the taxable year in which the disaster occurred (April 15th).

Under current state law, the rules that apply for disaster loss treatment depend on whether the disaster is Presidentially-declared or Governor-only declared or both.

- **Presidentially-declared:** If a disaster is only declared by the President, the taxpayer is allowed to make a disaster loss election to file a prior-year amended return prior to enactment of state legislation because California conforms to federal disaster tax law treatment.² Any loss in excess of the amount claimed on the prior year return would be deducted as a Net Operating Loss (NOL), as discussed below.

¹ For purposes of state income tax law, AGI is defined by cross-reference to the Internal Revenue Code (IRC) as gross income, which includes all income from whatever source derived, adjusted for certain allowable amounts, including IRA contributions, alimony paid, moving expenses, and Keogh account contributions.

² IRC section 165(i) provides federal disaster loss treatment by allowing the taxpayer to elect to claim a disaster loss deduction on a prior-year amended return when the President declares a disaster.

- Governor-only declared: If a disaster is only declared by the Governor and state legislation is enacted then the taxpayer is allowed to make a disaster loss election to file a prior-year amended return and carry forward (deduct) any disaster losses in excess of the amount that can be claimed on the prior year return or the original return for up to 15 taxable years.
- Presidentially and Governor declared (both): If a disaster is declared by the President and the Governor, then the same rules apply as a Governor-only declared disaster, except that the taxpayer can make a disaster loss election to file a prior-year amended prior to the enactment of state legislation.

State law is generally amended for each Governor-only declared disaster to allow taxpayers to make a disaster loss election to file a prior-year amended return, which for most individuals is by October 15th (the extended due date of the original return for the taxable year in which the disaster occurred). The extended due date for corporations varies based on each corporation's fiscal year. The election is made by the act of filing the amended return claiming the disaster loss.

NOLs

Under federal and state law, an NOL is created when business deductions exceed gross income. As a general rule, an individual taxpayer cannot have an NOL unless the taxpayer's return contains business deductions. A significant exception exists for casualty losses. Any deductible personal casualty loss of an individual is treated as a business deduction. Thus, an individual taxpayer can have an NOL if their personal casualty loss exceeds their income.

Under federal law, an NOL may be carried back as far as two years to generate a refund. Any remaining NOL may be carried forward up to 20 years to reduce future income tax liabilities.

California conforms to the federal NOL rules with modifications to the NOL carrybacks. Beginning on or after January 1, 2013, NOL carrybacks are allowed for 2 years at the following percentages:

- 50 percent for NOL carrybacks attributable to taxable years beginning on or after January 1, 2013, and before January 1, 2014.
- 75 percent for NOL carrybacks attributable to taxable years beginning on or after January 1, 2014, and before January 1, 2015.
- 100 percent for NOL carrybacks attributable to taxable years beginning on or after January 1, 2015.

Once state legislation is enacted for disaster loss treatment, the rules for NOLs do not apply and the taxpayer must claim their losses arising from a disaster loss using the disaster loss treatment.

Program History/Background

The President has the authority to declare natural disasters or hazards (i.e. chemical spill, dam failure, hazardous material, hurricane, earthquake, flood, tornado or major fire). For Presidentially declared disasters or hazards, the Governor of the affected state makes a request to the President for a Presidential declaration that a disaster exists.

Such a request is based on a finding that the disaster is of such severity and magnitude that effective response is beyond the capabilities of the state and the affected local governments and that federal assistance is necessary.

Generally, the Governor has authority to proclaim a state of emergency declaring natural disasters (i.e., wildfires, earthquakes, mudslides, floods, and severe winter storms). Upon proclamation by the Governor of a state emergency, the Legislature can propose legislation to provide special tax treatment, called disaster loss treatment, to taxpayers affected by the disaster. The Governor can proclaim a disaster within the state for the same disaster declared by the President, or the Governor can proclaim a disaster within the state that the President did not declare—also called a Governor-only proclaimed disaster.

Over the past five years, there have been approximately 21 Governor proclaimed disasters, in California of which 11 were Governor-only proclaimed disasters. There were 14 bills signed by the Governor that covered the 21 disasters and allowed disaster loss treatment. For example, AB 1568 (Salas, Stats. 2009, Ch. 299.) provided disaster loss treatment for three separate wildfires (two in 2008 and one in 2009) was not enacted until October 11, 2009, four days before the election deadline.

Problem

Because disaster loss bills are frequently signed into law at the end of a legislative year, which is mid-October, and disaster loss elections must be made by October 15, taxpayers frequently have an unreasonably short time to prepare an amended return and are uncertain whether they will receive the intended tax relief.

Proposed Solution

Amend Revenue and Taxation Code sections 17207 and 24347.5 to make income tax disaster loss treatment automatic when the Governor proclaims a state of emergency related to a Presidentially-declared or Governor-only proclaimed disaster.

Effective/Operative Date of Solution

If enacted in the 2011 legislative session, this proposal would be effective and operative for Governor disaster proclamations made on or after January 1, 2012.

Justification

This proposal would eliminate the hurdle of enactment of legislation before income tax relief is available to victims of a disaster by allowing these victims a reasonable time to prepare and file an amended return to claim relief.

Implementation

Implementing this proposal would require changes to existing notices, letters, and instructions. These changes would be accomplished during the department's normal annual update.

Fiscal Impact

This proposal would not impact the department's costs.

Economic Impact

Revenue Estimate

This proposal would have the following revenue impact:

| Estimated Revenue Impact of TP D Tax Years Beginning On Or After January 1, 2012 Enactment Assumed by September 30, 2011 Assumed \$10 Million of Annual Uninsured Loss | | | |
|--|-------------|------------|-----------|
| 2010-11 | 2011-12 | 2012-13 | 2013-14 |
| \$0 | (\$150,000) | (\$50,000) | +\$90,000 |

This estimate does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

The revenue impact for this estimate depends upon the following:

- The size of the disaster. By their nature, disasters are unpredictable. The extent to which disaster losses will be covered by insurance depends, in part, on the type of disaster. Given current insurance coverage, it is likely that insurance coverage is greatest for fires and less for floods and earthquakes.
- The year in which the disaster takes place. Provisions relating to the phase-in of net operating loss carry backs will affect the extent to which taxpayers can carry back disaster-related losses as casualty losses.
- The type of disaster declaration. Current law provides different treatment for disasters declared by the President from disasters proclaimed by the Governor.

The estimate above illustrates the impact of \$10 million in annual uninsured losses for 2012, 2013, and 2014, with an estimated 45 percent of losses being deducted against income in each of the first two years in which a deduction could be claimed and an estimated 10 percent in the third year. Half of the losses are attributed to Governor-declared disasters and half to President-declared disasters. A marginal tax rate of 6 percent was applied. Losses claimed on amended returns were accrued to the prior year.

For disasters that occur in 2012 and 2013, this proposal would provide more tax benefits than current law, because taxpayers in Governor-declared disasters would be able to use all of their uninsured losses against income. However, because this proposal would require that the losses be carried forward, as opposed to carried back as NOL treatment allows, this proposal would provide less tax benefits for taxpayers in future tax years.

Beginning in 2014, current law provides a 75 percent NOL carryback. For disasters occurring in 2015 and later, current law would allow the taxpayer to elect to deduct the disaster loss on the prior year return and then carry back the remaining loss at 100 percent under the NOL carryback rules. Under this proposal, taxpayers would be unable to carryback any losses under NOL carryback rules and would have to carry forward excess losses to future years.

Other States

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida does not have a personal income tax; however, monetary relief is provided to citizens and corporations through the Emergency Management, Preparedness, and Assistance Trust Fund. The trust fund is financed by surcharges on certain insurance policies; the money is used to support emergency management activities that are a result of a disaster (i.e. remove debris, protect life, health and safety, and rebuild damaged infrastructure) at both the state and local level. For corporations, Florida allows automatic disaster loss treatment when the President or Governor issues a declaration, executive order or proclamation to identify the area impacted by a disaster.

Illinois, Massachusetts, Michigan, Minnesota, and New York conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state returns either in the preceding year or in the year of the loss. These states allow automatic disaster loss treatment when the President or Governor issues a declaration, executive order, or proclamation to identify the area impacted by a disaster that is eligible for federal or state assistance.

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FRANCHISE TAX BOARD'S
TP D

AMENDMENT 1

SEC. XX. Section 17207 of the Revenue and Taxation Code is amended to read:

17207. (a) An excess disaster loss, as defined in subdivision (c), shall be carried to other taxable years as provided in subdivision (b), with respect to losses resulting from any of the following disasters:

(1) Forest fire or any other related casualty occurring in 1985 in California.

(2) Storm, flooding, or any other related casualty occurring in 1986 in California.

(3) Any loss sustained during 1987 as a result of a forest fire or any other related casualty.

(4) Earthquake, aftershock, or any other related casualty occurring in 1987 in California.

(5) Earthquake, aftershock, or any other related casualty occurring in 1989 in California.

(6) Any loss sustained during 1990 as a result of fire or any other related casualty in California.

(7) Any loss sustained as a result of the Oakland/Berkeley Fire of 1991, or any other related casualty.

(8) Any loss sustained as a result of storm, flooding, or any other related casualty occurring in February 1992 in California.

(9) Earthquake, aftershock, or any other related casualty occurring in April 1992 in the County of Humboldt.

(10) Riots, arson, or any other related casualty occurring in April or May 1992 in California.

(11) Any loss sustained as a result of the earthquakes that occurred in the County of San Bernardino in June and July of 1992, or any other related casualty.

(12) Any loss sustained as a result of the Fountain Fire that occurred in the County of Shasta, or as a result of either of the fires in the Counties of Calaveras and Trinity that occurred in August 1992, or any other related casualty.

(13) Any loss sustained as a result of storm, flooding, or any other related casualty that occurred in the Counties of Alpine, Contra Costa, Fresno, Humboldt, Imperial, Lassen, Los Angeles, Madera, Mendocino, Modoc, Monterey, Napa, Orange, Plumas, Riverside, San Bernardino, San Diego, Santa Barbara, Sierra, Siskiyou, Sonoma, Tehama, Trinity, and Tulare, and the City of Fillmore in January 1993.

(14) Any loss sustained as a result of a fire that occurred in the Counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura, during October or November of 1993, or any other related casualty.

(15) Any loss sustained as a result of the earthquake, aftershocks, or any other related casualty that occurred in the

Counties of Los Angeles, Orange, and Ventura on or after January 17, 1994.

(16) Any loss sustained as a result of a fire that occurred in the County of San Luis Obispo during August of 1994, or any other related casualty.

(17) Any loss sustained as a result of the storms or flooding occurring in 1995, or any other related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms and flooding.

(18) Any loss sustained as a result of the storms or flooding occurring in December 1996 or January 1997, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms or flooding.

(19) Any loss sustained as a result of the storms or flooding occurring in February 1998, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms or flooding.

(20) Any loss sustained as a result of a freeze occurring in the winter of 1998-99, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the freeze.

(21) Any loss sustained as a result of an earthquake occurring in September 2000, that was included in the Governor's proclamation of a state of emergency for the County of Napa.

(22) Any loss sustained as a result of the Middle River levee break in San Joaquin County occurring in June 2004.

(23) Any losses sustained as a result of the fires that occurred in the Counties of Los Angeles, Riverside, San Bernardino, San Diego, and Ventura in October and November 2003, or as a result of floods, mudflows, and debris flows, directly related to fires.

(24) Any losses sustained in the Counties of Santa Barbara and San Luis Obispo as a result of the San Simeon earthquake, aftershocks, and any other related casualties.

(25) Any losses sustained as a result of the wildfires that occurred in Shasta County, commencing August 11, 2004, and any other related casualty.

(26) Any loss sustained in the Counties of Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura as a result of the severe rainstorms, related flooding and slides, and any other related casualties, that occurred in December 2004, January 2005, February 2005, March 2005, or June 2005.

(27) Any loss sustained in the Counties of Alameda, Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Fresno, Humboldt, Kings, Lake, Lassen, Madera, Marin, Mariposa, Mendocino, Merced, Monterey, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, San Luis Obispo, San Mateo, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Stanislaus, Sutter, Trinity, Tulare, Tuolumne, Yolo, and Yuba as a result of the severe rainstorms, related flooding and slides, and any other related casualties, that occurred in December 2005, January 2006, March 2006, or April 2006.

(28) Any loss sustained in the County of San Bernardino as a result of the wildfires that occurred in July 2006.

(29) Any loss sustained in the Counties of Riverside and Ventura as a result of wildfires that occurred during the 2006 calendar year.

(30) Any loss sustained in the Counties of El Dorado, Fresno, Imperial, Kern, Kings, Madera, Merced, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Santa Clara, Stanislaus, Tulare, Ventura, and Yuba that were the subject of the

Governor's proclamations of a state of emergency for the severe freezing conditions that occurred in January 2007.

(31) Any loss sustained in the County of El Dorado as a result of wildfires that occurred in June 2007.

(32) Any loss sustained in the Counties of Santa Barbara and Ventura as a result of the Zaca Fire that occurred during the 2007 calendar year.

(33) Any loss sustained in the County of Inyo as a result of wildfires that commenced in July 2007.

(34) Any loss sustained in the Counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura as a result of wildfires that occurred during the 2007 calendar year that were the subject of the Governor's disaster proclamations of September 15, 2007, and October 21, 2007.

(35) Any loss sustained in the County of Riverside as a result of extremely strong and damaging winds that occurred in October 2007.

(36) Any loss sustained in the Counties of Butte, Kern, Mariposa, Mendocino, Monterey, Plumas, Santa Clara, Santa Cruz, Shasta, and Trinity as a result of wildfires that occurred in May or June 2008 that were the subject of the Governor's proclamations of a state of emergency.

(37) Any loss sustained in the County of Santa Barbara as a result of wildfires that occurred in July 2008.

(38) Any loss sustained in the County of Inyo as a result of the severe rainstorms, related flooding and landslides, and any other related casualties, that occurred in July 2008.

(39) Any loss sustained in the County of Humboldt as a result of wildfires that commenced in May 2008.

(40) Any loss sustained in the County of Santa Barbara as a result of wildfires that commenced in November 2008.

(41) Any loss sustained in the Counties of Los Angeles and Ventura as a result of wildfires that commenced in October 2008 or November 2008 that were the subject of the Governor's proclamations of a state of emergency.

(42) Any loss sustained in the Counties of Orange, Riverside, and San Bernardino as a result of wildfires that commenced in November 2008.

(43) Any loss sustained in the County of Santa Barbara as a result of wildfires that commenced in May 2009.

(b) (1) In the case of any loss allowed under Section 165(c) of the Internal Revenue **Code**, relating to limitation of losses of individuals, any excess disaster loss shall be carried forward to each of the five taxable years following the taxable year for which the loss is claimed. However, if there is any excess disaster loss remaining after the five-year period, then the applicable percentage, as set forth in paragraph (1) of subdivision (b) of Section 17276, of that excess disaster loss shall be carried forward to each of the next 10 taxable years.

(2) The entire amount of any excess disaster loss as defined in subdivision (c) shall be carried to the earliest of the taxable years to which, by reason of subdivision (b), the loss may be carried. The portion of the loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of excess disaster loss over the sum of the adjusted taxable income for each of the prior taxable years to which that excess disaster loss is carried.

(c) "Excess disaster loss" means a disaster loss computed pursuant to Section 165 of the Internal Revenue **Code** which exceeds the adjusted taxable income of the year of loss or, if the election under

Section 165(i) of the Internal Revenue **Code** is made, the adjusted taxable income of the year preceding the loss.

(d) The provisions of this section and Section 165(i) of the Internal Revenue **Code** shall be applicable to any of the losses listed in subdivision (a) and any loss on or after January 1, 2012, sustained in any county or city in this state which was proclaimed by the Governor to be in a state of disaster.

(e) Losses allowable under this section may not be taken into account in computing a net operating loss deduction under Section 172 of the Internal Revenue **Code**.

(f) For purposes of this section, "adjusted taxable income" shall be defined by Section 1212(b)(2)(B) of the Internal Revenue **Code**.

(g) For losses described in paragraphs (15) to (43), inclusive, of subdivision (a) or in subdivision (d), the election under Section 165(i) of the Internal Revenue **Code** may be made on a return or amended return filed on or before the due date of the return (determined with regard to extension) for the taxable year in which the disaster occurred.

(h) The amendments to this section are operative for proclamations made by the Governor on or after the effective date of the act adding this subdivision.

AMENDMENT 2

SEC. XX. Section 24347.5 of the Revenue and Taxation Code is amended to read:

24347.5. (a) An excess disaster loss, as defined in subdivision (c), shall be carried to other taxable years as provided in subdivision (b), with respect to losses resulting from any of the following disasters:

(1) Forest fire or any other related casualty occurring in 1985 in California.

(2) Storm, flooding, or any other related casualty occurring in 1986 in California.

(3) Any loss sustained during 1987 as a result of a forest fire or any other related casualty.

(4) Earthquake, aftershock, or any other related casualty occurring in October 1987 in California.

(5) Earthquake, aftershock, or any other related casualty occurring in October 1989 in California.

(6) Any loss sustained during 1990 as a result of fire or any other related casualty in California.

(7) Any loss sustained as a result of the Oakland/Berkeley Fire of 1991, or any other related casualty.

(8) Any loss sustained as a result of storm, flooding, or any other related casualty occurring in February 1992 in California.

(9) Earthquake, aftershock, or any other related casualty occurring in April 1992 in the County of Humboldt.

(10) Riots, arson, or any other related casualty occurring in April or May 1992 in California.

(11) Any loss sustained as a result of the earthquakes or any other related casualty that occurred in the County of San Bernardino in June and July of 1992.

(12) Any loss sustained as a result of the Fountain Fire that occurred in the County of Shasta, or as a result of either of the fires in the Counties of Calaveras and Trinity that occurred in August 1992, or any other related casualty.

(13) Any loss sustained as a result of storm, flooding, or any other related casualty that occurred in the Counties of Alpine, Contra Costa, Fresno, Humboldt, Imperial, Lassen, Los Angeles,

Madera, Mendocino, Modoc, Monterey, Napa, Orange, Plumas, Riverside, San Bernardino, San Diego, Santa Barbara, Sierra, Siskiyou, Sonoma, Tehama, Trinity, and Tulare, and the City of Fillmore in January 1993.

(14) Any loss sustained as a result of a fire that occurred in the Counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura, during October or November of 1993, or any other related casualty.

(15) Any loss sustained as a result of the earthquake, aftershocks, or any other related casualty that occurred in the Counties of Los Angeles, Orange, and Ventura on or after January 17, 1994.

(16) Any loss sustained as a result of a fire that occurred in the County of San Luis Obispo during August of 1994, or any other related casualty.

(17) Any loss sustained as a result of the storms or flooding occurring in 1995, or any other related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms and flooding.

(18) Any loss sustained as a result of the storms or flooding occurring in December 1996 or January 1997, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms or flooding.

(19) Any loss sustained as a result of the storms or flooding occurring in February 1998, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the storms or flooding.

(20) Any loss sustained as a result of a freeze occurring in the winter of 1998-99, or any related casualty, sustained in any county of this state subject to a disaster declaration with respect to the freeze.

(21) Any loss sustained as a result of an earthquake occurring in September 2000, that was included in the Governor's proclamation of a state of emergency for the County of Napa.

(22) Any loss sustained as a result of the Middle River levee break in San Joaquin County occurring in June 2004.

(23) Any losses sustained as a result of the fires that occurred in the Counties of Los Angeles, Riverside, San Bernardino, San Diego, and Ventura in October and November 2003, or as a result of floods, mudflows, and debris flows, directly related to fires.

(24) Any losses sustained in the Counties of Santa Barbara and San Luis Obispo as a result of the San Simeon earthquake, aftershocks, and any other related casualties.

(25) Any losses sustained as a result of the wildfires that occurred in Shasta County, commencing August 11, 2004, and any other related casualty.

(26) Any loss sustained in the Counties of Kern, Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura as a result of the severe rainstorms, related flooding and slides, and any other related casualties, that occurred in December 2004, January 2005, February 2005, March 2005, or June 2005.

(27) Any loss sustained in the Counties of Alameda, Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Fresno, Humboldt, Kings, Lake, Lassen, Madera, Marin, Mariposa, Mendocino, Merced, Monterey, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, San Luis Obispo, San Mateo, Santa Cruz, Shasta, Sierra, Siskiyou, Solano, Sonoma, Stanislaus, Sutter, Trinity, Tulare, Tuolumne, Yolo, and Yuba as a result of the severe rainstorms, related flooding and slides, and any other related

casualties, that occurred in December 2005, January 2006, March 2006, or April 2006.

(28) Any loss sustained in the County of San Bernardino as a result of the wildfires that occurred in July 2006.

(29) Any loss sustained in the Counties of Riverside and Ventura as a result of wildfires that occurred during the 2006 calendar year.

(30) Any loss sustained in the Counties of El Dorado, Fresno, Imperial, Kern, Kings, Madera, Merced, Monterey, Riverside, San Bernardino, San Diego, San Luis Obispo, Santa Barbara, Santa Clara, Stanislaus, Tulare, Ventura, and Yuba that were the subject of the Governor's proclamations of a state of emergency for the severe freezing conditions that occurred in January 2007.

(31) Any loss sustained in the County of El Dorado as a result of wildfires that occurred in June 2007.

(32) Any loss sustained in the Counties of Santa Barbara and Ventura as a result of the Zaca Fire that occurred during the 2007 calendar year.

(33) Any loss sustained in the County of Inyo as a result of wildfires that commenced in July 2007.

(34) Any loss sustained in the Counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, and Ventura as a result of wildfires that occurred during the 2007 calendar year that were the subject of the Governor's disaster proclamations of September 15, 2007, and October 21, 2007.

(35) Any loss sustained in the County of Riverside as a result of extremely strong and damaging winds that occurred in October 2007.

(36) Any loss sustained in the Counties of Butte, Kern, Mariposa, Mendocino, Monterey, Plumas, Santa Clara, Santa Cruz, Shasta, and Trinity as a result of wildfires that occurred in May or June 2008 that were the subject of the Governor's proclamations of a state of emergency.

(37) Any loss sustained in the County of Santa Barbara as a result of wildfires that occurred in July 2008.

(38) Any loss sustained in the County of Inyo as a result of the severe rainstorms, related flooding and landslides, and any other related casualties, that occurred in July 2008.

(39) Any loss sustained in the County of Humboldt as a result of wildfires that commenced in May 2008.

(40) Any loss sustained in the County of Santa Barbara as a result of wildfires that commenced in November 2008.

(41) Any loss sustained in the Counties of Los Angeles and Ventura as a result of wildfires that commenced in October 2008 or November 2008 that were the subject of the Governor's proclamations of a state of emergency.

(42) Any loss sustained in the Counties of Orange, Riverside, and San Bernardino as a result of wildfires that commenced in November 2008.

(43) Any loss sustained in the County of Santa Barbara as a result of wildfires that commenced in May 2009.

(b) (1) In the case of any loss allowed under Section 165 of the Internal Revenue **Code**, relating to losses, any excess disaster loss shall be carried forward to each of the five taxable years following the taxable year for which the loss is claimed. However, if there is any excess disaster loss remaining after the five-year period, then the applicable percentage, as set forth in paragraph (1) of subdivision (b) of Section 24416, of that excess disaster loss shall be carried forward to each of the next 10 taxable years.

(2) The entire amount of any excess disaster loss as defined in subdivision (c) shall be carried to the earliest of the taxable years

to which, by reason of subdivision (b), the loss may be carried. The portion of the loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of excess disaster loss over the sum of the net income for each of the prior taxable years to which that excess disaster loss is carried.

(c) "Excess disaster loss" means a disaster loss computed pursuant to Section 165 of the Internal Revenue **Code**, which exceeds the net income of the year of loss or, if the election under Section 165(i) of the Internal Revenue **Code** is made, the net income of the year preceding the loss.

(d) The provisions of this section and Section 165(i) of the Internal Revenue **Code** shall be applicable to any of the losses listed in subdivision (a) and any loss on or after January 1, 2012, sustained in any county or city in this state which was proclaimed by the Governor to be in a state of disaster.

(e) Any corporation subject to the provisions of Section 25101 or 25101.15 that has disaster losses pursuant to this section, shall determine the excess disaster loss to be carried to other taxable years under the principles specified in Section 25108 relating to net operating losses.

(f) Losses allowable under this section may not be taken into account in computing a net operating loss deduction under Section 172 of the Internal Revenue **Code**.

(g) For losses described in paragraphs (15) to (43), inclusive, of subdivision (a) or in subdivision (d), the election under Section 165(i) of the Internal Revenue **Code** may be made on a return or amended return filed on or before the due date of the return (determined with regard to extension) for the taxable year in which the disaster occurred.

(h) The amendments to this section are operative for proclamations made by the Governor on or after the effective date of the act adding this subdivision.

TAXPAYER PROPOSAL E EXECUTIVE SUMMARY

- **Title:** Modify Interest Calculation for the California Tax Effects of Reporting a “Carryback” of a Net Operating Loss (NOL) Deduction for Another State or for California

➤ **Problem Statement:**

1. Some taxpayers believe current California law unfairly charges interest in the follow scenario:
 - a California taxpayer claimed the OSTC on their California return,
 - the taxpayer realizes an NOL in a subsequent year in another state,
 - the taxpayer carries that NOL back to a prior year by filing an amended return in the other state reducing their tax in the other state,
 - because of the reduced tax in the other state, the taxpayer must report a decrease of the OSTC to California, which creates an underpayment of tax,
 - the other state pays interest to the taxpayer on the overpayment beginning the date the return that generated the NOL was filed,
 - California charges the taxpayer interest on the resulting increase in California tax from the date the prior year California return was originally filed rather than from the date the original return that generated the NOL was filed in the other state.
2. Some taxpayers believe current California law should be the same as federal law regarding the interest computation in the follow scenario:
 - a California taxpayer realizes an NOL on its California and federal returns for the current year,
 - the taxpayer carries back the NOL to a prior year both for federal and for California (when allowed) to reduce the tax in a prior year,
 - the IRS pays interest for the federal overpayment in the prior year beginning on the date the taxpayer filed the federal return that generated the NOL,
 - California pays interest for the California overpayment in the prior year beginning on the later of the original due date or the date the return the NOL was carried back to was filed.

➤ **Proposed Solution**

1. Amend the Revenue and Taxation Code rule for determining when California begins to charge interest for a decrease to the OSTC reported on an amended return as follows:
 - **from** the later of the original due date of the return or the date filed,
 - **to** the date the return is filed for the taxable year in which the NOL arises. This modification would only apply for purposes of the underpayment interest computation and only for circumstances where the revised OSTC was the result of an NOL carryback in the other state.

2. Amend the Revenue and Taxation Code to conform to the federal rule for computation of interest on overpayments that result from an application of an NOL carryback. The California rule would be changed as follows:
- **from** the later of the original due date or the date the return is filed to which the NOL was carried back,
 - **to** the date the return is filed that generates the NOL..

➤ **Major Issues/Concerns:**

Problem 1: Current law is based on reimbursement to the State for the time value of the amount of tax underpaid and is a long-established policy decision of the Legislature.

Problem 2: California law will not allow NOL carrybacks until taxable years beginning January 1, 2013. There are numerous additional collateral federal rules for NOL carrybacks that should be identified by staff for possible enactment as a comprehensive package.

Title

Modify Interest Calculation for the California Tax Effects of Reporting a “Carryback” of a Net Operating Loss (NOL) Deduction for Another State or for California

Introduction

This proposal would change interest calculations associated with NOL deductions in two narrow circumstances.

Current Federal/State Law

Federal Law

Underpayments¹

Generally, an underpayment of taxes occurs when a taxpayer’s tax liability for a taxable year is greater than the payments made by the taxpayer to cover their tax liability. An underpayment can occur for a variety of reasons including when a taxpayer amends a previously filed return to report additional income, to decrease deductions or to decrease tax credits for that year. The net effect of any of these is that more tax is owed for the previously filed tax year.

If there is an underpayment, interest is charged to taxpayers under specific rules. If any amount of tax is not paid by the last day for payment resulting in an underpayment, without regard for extensions to pay or installment agreements entered into by the taxpayer, interest will be calculated on the amount of the underpayment beginning from the last day for payment. The last day for payment is the date the tax liability arises and is generally the original due date of the tax return, but will not be later than the date the Secretary of the Treasury issues a notice and demand for the tax. The current interest rate charged for an underpayment is four percent.

Overpayments²

Generally, an overpayment of taxes occurs when a taxpayer has paid more than the amount of their tax liability. An overpayment can occur as the result of amending a previously filed return to report a decrease in the amount of taxable income or an increase to allowed deductions or credits. The net effect of any of these is that less tax is owed for the previously filed tax year, and the taxpayer is entitled to a refund.

Interest is paid on overpayments under specific rules. If an overpayment is from the carryback of an NOL, the overpayment is deemed to arise on the filing date of the original return for the taxable year from which the NOL arose. Filing date means the later of the date the return was filed or the original due date without taking into account extensions.

¹ IRC section 6601.

² IRC section 6611.

Interest allowed on an overpayment is calculated at an established rate.³ The current interest rate paid for an overpayment is four percent for non-corporate taxpayers and three percent for corporate taxpayers. Interest is calculated from the date of overpayment to the date paid, less time to process the check or other form of payment. The time to process the payment could be up to 30 days.

If a taxpayer files a claim for refund and the refund is paid within 45 days of the date filed, no interest will be paid on the refund amount.

California Law⁴

Current California law provides that interest is charged on underpayments of tax from the last day prescribed for payment to the date the payment is made. The last day prescribed for payment is the date the tax liability arises, not later than the date notice and demand is made by the Franchise Tax Board (FTB). This generally is the due date of the tax return, without regard for extensions to file.

Current California law also provides that interest is paid on overpayments of tax from the date of the overpayment to the date paid, less time to process the check or other form of payment. The time to process the payment could be up to 30 days. Unlike federal law, California has no interest rules specific to NOL carrybacks. Accordingly, the general rule for payment of interest would be applied. That rule is that overpayment interest is generally paid from the original due date of the return, regardless of when the claim for refund is filed. Interest is not paid if a refund is made to a corporation within 90 days from the date the return is filed or to an individual within 45 days of the date the return is filed, or for periods before a return is filed if the return was filed after the extended due date. There are no special rules for overpayments resulting from the carry back of an NOL. As a result, a taxpayer filing an amended return to deduct an NOL carryback will receive interest from the date of the original payment.

SB 858 (Committee on Budget and Fiscal Review, Stats. 2010, Ch. 721) postponed the operative date for the use of NOL carrybacks by two years to taxable years beginning on or after January 1, 2013.

Current California law allows a credit for taxes paid to other states on income taxed by both states. When the tax for which a credit is allowed is reduced or changed by the other state, California requires a corresponding change to the California other state tax credit (OSTC). Underpayment interest is charged on the change to the California OSTC from the date the OSTC was originally allowed, usually the original due date of the return claiming the original OSTC, although overpayment interest is generally not paid by the other state on the reduction in that state's tax for that same year.

³ IRC section 6621.

⁴ RT&C sections 18007 – 18009, 19101, 19340, and 19521.

Problem

1. Some taxpayers believe current California law unfairly charges interest in the follow scenario:
 - a California taxpayer claimed the OSTC on their California return,
 - the taxpayer realizes an NOL in a subsequent year in another state,
 - the taxpayer carries that NOL back to a prior year by filing an amended return in the other state reducing their tax in the other state,
 - because of the reduced tax in the other state, the taxpayer must report a decrease of the OSTC to California, which creates an underpayment of tax,
 - the other state pays interest to the taxpayer on the overpayment beginning the date the return that generated the NOL was filed,
 - California charges the taxpayer interest on the resulting increase in California tax from the date the prior year California return was originally filed rather than from the date the original return that generated the NOL was filed in the other state.
2. Some taxpayers believe current California law should be the same as federal law regarding the interest computation in the follow scenario:
 - a California taxpayer realizes an NOL on its California and federal returns for the current year,
 - the taxpayer carries back the NOL to a prior year both for federal and for California (when allowed) to reduce the tax in a prior year,
 - the IRS pays interest for the federal overpayment in the prior year beginning on the date the taxpayer filed the federal return that generated the NOL,
 - California pays interest for the California overpayment in the prior year beginning on the later of the original due date or the date the return the NOL was carried back to was filed.

Proposed Solutions

1. Amend the Revenue and Taxation Code rule for determining when California begins to charge interest for a decrease to the OSTC reported on an amended return as follows:
 - **from** the later of the original due date of the return or the date filed,
 - **to** the date the return is filed for the taxable year in which the NOL arises. This modification would only apply for purposes of the underpayment interest computation and only for circumstances where the revised OSTC was the result of an NOL carryback in the other state.
2. Amend the Revenue and Taxation Code to conform to the federal rule for computation of interest on overpayments that result from an application of an NOL carryback. The California rule would be changed as follows:
 - **from** the later of the original due date or the date the return is filed to which the NOL was carried back,
 - **to** the date the return is filed that generates the NOL.

Effective/Operative Date of Solution

Assuming that the legislation would be enacted during 2011:

- Solution 1: An amendment to modify the date that California begins to charge interest when a taxpayer has an underpayment of tax that resulted from a change to OSTC, would be effective and operative for amended returns filed on or after January 1, 2012.
- Solution 2: An amendment to change the computation of interest on overpayments resulting from an application of an NOL carryback to begin to accrue on or after the date the return that generates the NOL is filed, would be effective on January 1, 2012, and operative for the same time as RT&C sections 17276.20 (c) and 24416.20 (d), which would be for taxable years beginning on or after January 1, 2013.

Justification

The solution for problem 1 would reduce perceived unfairness between the period another state uses to compute interest due to the taxpayer for an overpayment when a taxpayer files an NOL carryback in the other state and the period California uses to charge interest for the related changes to California's OSTC triggered by the same NOL.

The solution for problem 2 would conform the NOL carryback interest calculation rules to match the federal rules, simplifying the preparation of the California return by removing a second set of rules for California when calculating interest related to an NOL carryback.

Fiscal Impact

Departmental Costs

The proposal for Solution 1 would not significantly impact the department's costs because there would be a minimal number of returns with this scenario and those returns would be handled manually, requiring no system change, reprogramming, or testing costs.

The department's costs to implement Solution 2 would be \$56,000 to modify the department's information systems, which includes reprogramming and testing.

Tax Revenue Estimate

| Estimated Revenue Impact of TP E Effective for Tax Years Beginning On Or After January 1, 2012 Enactment Date Assumed After September 30, 2010 (\$ in millions) | | | |
|--|---------|---------|---------|
| | 2012-13 | 2013-14 | 2014-15 |
| Underpayment Interest | -0.8 | -1.0 | -1.2 |
| Overpayment Interest | 0.2 | 5.3 | 8.0 |
| Total | -0.6 | 4.3 | 6.8 |

This analysis does not account for changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion:

Underpayment Interest

The revenue impact of not charging interest on underpayments generated by reporting the California tax effects of NOL carrybacks in other states was estimated from data on the use of the OSTC. In 2008, taxpayers used about \$500 million in OSTC. It was assumed that this proposal would result in approximately a 2 percent (\$10 million) reduction in this credit via amended returns. The projected interest rate was then applied to this amount and the estimate was converted to fiscal years.

Overpayment Interest

The revenue impact of not paying interest for the period prior to filing for an NOL for refunds generated by an NOL carryback was simulated using FTB's NOL model. It was estimated that \$565 million in NOLs would be carried back in 2012. Of these, 73 percent would be carried back two years and the remaining 27 percent would be carried back one year. An interest rate taken from the FTB overpayment/underpayment interest rate schedule was applied with the initial rate being zero and grown according to Department of Finance projections to reach 4 percent by 2015. The estimate assumes that about half of the refunds generated by carrybacks will not be issued until after an audit of the tax year generating the carryback has been completed.

Other Considerations:

Problem 1: Current law is based on reimbursement to the State for the time value of the amount of tax underpaid and is a long-established policy decision of the Legislature.

Problem 2: California law will not allow NOL carrybacks until taxable years beginning January 1, 2013. There are numerous additional collateral federal rules for NOL carrybacks that should be identified by staff for possible enactment as a comprehensive package.

| | |
|-------------|----------------|
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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO TP E

AMENDMENT 1

Section 18009 of the Revenue and Taxation Code is amended to read:

18009. (a) Interest shall be assessed, collected and paid in the same manner as the tax at the adjusted annual rate established pursuant to Section 19521 from the date the credit was allowed under this part to the date of payment.

(b) For purposes of this section, if the taxpayer has been allowed a credit or refunded taxes in another state and reports the change to the Franchise Tax Board as required by Section 18007, and if the change is the result of an net operating loss carryback applied in the other state, then the date the credit was allowed for California reporting purposes shall be deemed not to have been before the filing date of the other state return in which that net operating loss arises for the other state.

AMENDMENT 2

Section 19340 of the Revenue and Taxation Code is amended to read:

19340. Interest shall be allowed and paid on any overpayment in respect of any tax, at the adjusted annual rate established pursuant to Section 19521 as follows:

(a) In the case of a credit, from the date of the overpayment to the due date of the amount for which the credit is allowed. Any interest allowed on any credit shall first be credited on any amounts due from the taxpayer under Part 10 (commencing with Section 17001), this part, or Part 11 (commencing with Section 23001).

(b) In the case of a refund, including a refund in excess of tax liability as prescribed in subdivision (j) of Section 17053.5, from the date of the overpayment to a date preceding the date of the refund warrant by not more than 30 days, the date to be determined by the Franchise Tax Board.

(c) For purposes of this section, if any overpayment of the "net tax" imposed under Part 10 (commencing with Section 17001) or the "tax" imposed under Part 11 (commencing with Section 23001) results from a net operating

loss carryback allowed under subdivision (c) of Section 17276.20 or subdivision (d) of Section 24416.20, that overpayment shall be deemed not to have been made before the filing date for the taxable year in which that net operating loss carryback arises.

(1) For purposes of this subdivision , the term "filing date" means the last date prescribed for filing the return of tax imposed under Part 10 (commencing with Section 17001) or the "tax" imposed under Part 11 (commencing with Section 23001) for the taxable year (determined without regard to extensions).

(2) (A) For purposes of this subdivision , the following shall apply:

(i) Any overpayment described in this subdivision shall be treated as an overpayment for the loss year,

(ii) That subdivision shall be applied with respect to the overpayment by treating the return for the loss year as not filed before a claim for that overpayment is filed.

(B) For purposes of this paragraph, the term "loss year" means the taxable year in which that loss arises.